

Message Text

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PAGE 01 MADRID 08083 01 OF 04 152210Z

ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08

FRB-01 INR-10 NSAE-00 SP-02 STR-07 TRSE-00 LAB-04

SIL-01 OMB-01 EA-12 IO-14 NEA-10 ICA-20 OPIC-06

AGRE-00 SS-15 DOE-15 SOE-02 H-02 HA-05 L-03 PA-02

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R 150744Z JUL 78

FM AMEMBASSY MADRID

TO SECSTATE WASHDC 5354

AMEMBASSY BONN

AMEMBASSY PARIS

AMEMBASSY LISBON

AMEMBASSY BRUSSELS

UNCLAS SECTION 01 OF 04 MADRID 08083

USOECDD; USEEC

E.O. 11652: N/A

TAGS: EFIN, ETRD, OECD, ECON, SP

SUBJECT: THE SPANISH ECONOMY: MONTHLY ROUNDUP AND KEY

STATISTICS - NUMBER 18

REF: MADRID 6357

1. SUMMARY: THE 1978 AUSTERITY MEASURES CONTAINED IN LAST FALL'S MONCLOA PACT ARE BEING CARRIED OUT NEARLY AS PLANNED, AND THE NEED FOR A SIMILAR CONSENSUS ON NEXT YEAR'S POLICIES IS NOW COMING TO THE FORE. THE NEWEST DATA SHOW THAT THE STABILIZATION PROGRAM HAS LED TO A DEFLATION CHARACTERIZED BY DISINVESTMENT AND REDUCED CAPACITY UTILIZATION, AND BY SHARPLY INCREASED UNEMPLOYMENT. THIS BELT TIGHTENING HAS BEEN REWARDED BY A MUCH LOWER RATE OF INFLATION IN THE FIRST FIVE MONTHS OF THE YEAR, AND BY A SHARP IMPROVEMENT IN THE BALANCE OF PAYMENTS. THERE HAVE

UNCLASSIFIED

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PAGE 02 MADRID 08083 01 OF 04 152210Z

BEEN SOME PROBLEMS ENCOUNTERED IN THE EXECUTION OF MONETARY AND FISCAL POLICIES, BUT NONE SERIOUS ENOUGH TO THREATEN OVERALL ECONOMIC GOALS. WHILE FOREIGN INVESTMENT IN SPAIN IS RECOVERING SOMEWHAT, THE WEST GERMAN FINANCE MINISTER HAS EXPRESSED CONCERN ABOUT RISING LABOR COSTS HERE. A NEW DECREE-LAW WILL LEAD TO THE ESTABLISHMENT IN SPAIN OF BRANCHES OF U.S. BANKS. THE NEGOTIATIONS ON

SPANISH ENTRY INTO THE EUROPEAN FREE TRADE ASSOCIATION (EFTA) HAVE ADVANCED, AND COULD BE CONCLUDED AS EARLY AS THIS FALL. END SUMMARY.

2. LAST FALL'S MONCLOA PACT ON ECONOMIC AND SOCIAL POLICY EXTENDS THROUGH 1978, AND PUBLIC DEBATE IS NOW TURNING TO HOW ECONOMIC POLICY WILL BE MADE FOR 1979 AND BEYOND. THERE IS ALREADY AN APPARENT POLITICAL CONSENSUS THAT A MULTY-PARTY STRATEGY SHOULD BE NEGOTIATED AND SHOULD COVER A TWO OR THREE YEAR PERIOD. THE SPANISH PRESS HAS ALSO POINTED OUT THAT THE JUST RELEASED OECD ANNUAL REPORT ON SPAIN FAVORS NEGOTIATION OF A NEW "SOCIAL PACT." THE MOST LIKELY CONTENT OF AN ECONOMIC PLAN FOR 1979 WOULD BE: AUSTERITY MEASURES ALONG THE GENERAL LINES OF THIS YEAR'S, NEW OR EXPANDED PROGRAMS TO REVIVE INVESTMENT AND TO TREAT UNEMPLOYMENT, AND MODIFICATIONS TO THE INFRASTRUCTURE OF THE ECONOMY.

3. WHEN NEGOTIATIONS MIGHT BEGIN IS UNCLEAR, AND SOME INSIDERS EXPECT THEM TO BE DELAYED UNTIL EARLY NEXT YEAR BECAUSE ATTENTION IN THE FALL WILL BE FOCUSED ON APPROVAL OF THE NEW SPANISH CONSTITUTION AND ON THE ELECTIONS WHICH ARE EXPECTED TO FOLLOW. SUCH A DELAY WOULD NOT BE WITHOUT COST BECAUSE WELL-PLANNED AUSTERITY MEASURES FOR 1979 ARE ESSENTIAL FOR A RECOVERY OF THE SPANISH ECONOMY. THE END-OF-THE YEAR LABOR NEGOTIATIONS, IN PARTICULAR, CANNOT BE UNCLASSIFIED

UNCLASSIFIED

PAGE 03 MADRID 08083 01 OF 04 152210Z

CONCLUDED IN A VACUUM.

4. THE ECONOMY IS PRESENTLY IN A DELICATE STATE OF CONTINUING DEFLATION, WITH PRODUCTION AND INVESTMENT FALLING WHILE UNEMPLOYMENT RISES. INDUSTRIAL CAPACITY UTILIZATION WAS DOWN SIGNIFICANTLY IN THE FIRST QUARTER (TO 79 PERCENT, FROM 82 PERCENT IN THE PREVIOUS QUARTER) AND IS STILL FALLING. INVESTMENT IN PLANT AND EQUIPMENT, ALREADY WELL BELOW THE REPLACEMENT LEVEL, IS FALLING QUICKLY. BUSINESS PROFITS, OF COURSE, ARE AT RECORD LOW LEVELS AND DEFAULT ON FINANCIAL OBLIGATIONS IS INCREASING MARKEDLY. IN THE PROVINCE OF MADRID NEWLY REGISTERED UNPAID BUSINESS DEBTS IN THE FIRST FIVE MONTHS OF THIS YEAR WERE 115.6 PERCENT HIGHER THAN IN THE SAME PERIOD IN 1977; SIMILAR INCREASES HAVE BEEN REGISTERED IN OTHER PROVINCES. FORTUNATELY THESE AUSTERITY SYMPTOMS ARE STILL BROADLY ACCEPTED BY SPANIARDS AND THEIR POLITICAL PARTIES AS THE PRICE TO BE PAID IN THE SO FAR SUCCESSFUL FIGHT AGAINST INFLATION.

5. IT HAS BEEN ESPECIALLY ENCOURAGING THAT CONSUMER PRICES ROSE ONLY 6.35 PERCENT IN THE FIRST FIVE MONTHS OF THE

YEAR. THIS IS WITHIN THE MONCLOA PACT LIMITS AND DRAMATICALLY BELOW 1977 INFLATION RATES. NEVERTHELESS, STRONG INFLATIONARY PRESSURES CONTINUE TO EXIST. THIS YEAR'S WAGE COSTS ARE RISING AT ROUGHLY THE 22 PERCENT ANNUAL RATE PROVIDED FOR IN THE MONCLOA PACT, AND MONETARY AND FISCAL RESULTS HAVE BEEN SOMEWHAT MORE INFLATIONARY THAN EXPECTED.

6. EVEN THE PRESIDENT OF THE BANK OF SPAIN, ALVAREZ RENDUELES, HAS ADMITTED THAT RECENTLY MONETARY POLICY HAS BEEN POORLY IMPLEMENTED. THE MONETARY GOAL THIS YEAR IS TO MAINTAIN A STEADY 17 PERCENT ANNUAL RISE IN THE BROAD MONEY SUPPLY (M3). INSTEAD, DURING THE FIRST QUARTER ECONOMIC SLACKNESS LED TO A LOW LIQUIDITY PREFERENCE AND

UNCLASSIFIED

PAGE 04 MADRID 08083 01 OF 04 152210Z

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PAGE 01 MADRID 08083 02 OF 04 152213Z
ACTION EUR-12

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FRB-01 INR-10 NSAE-00 SP-02 STR-07 TRSE-00 LAB-04
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UNCLAS SECTION 02 OF 04 MADRID 08083

USOEC; USEEC

MONETARY GROWTH BELOW TARGETS, DESPITE BANK OF SPAIN EFFORTS TO PUMP MORE LIQUIDITY INTO THE SYSTEM. THE

SITUATION IN THE SECOND QUARTER WAS REVERSED, AND CAUGHT THE CENTRAL BANK BY SURPRISE. THE MONEY SUPPLY BEGAN TO RISE RAPIDLY BECAUSE OF CLIMBING FOREIGN EXCHANGE RESERVES, FUNDING A BIGGER-THAN-EXPECTED FIRST QUARTER FISCAL DEFICIT, AND A RECOVERY IN THE PRIVATE DEMAND FOR LIQUIDITY. AS A RESULT THE MONEY SUPPLY GREW MUCH MORE RAPIDLY IN THE SECOND QUARTER THAN THE 17 PERCENT TARGET, AND THE BANK OF SPAIN WAS FORCED TO TAKE MEASURES TO REVERSE THE SITUATION AGAIN. ON JUNE 20 THE CENTRAL BANK RESERVE RATIO WAS INCREASED BY ONE-HALF PERCENT, THE VOLUME OF OUTSTANDING SHORT TERM LOANS TO FINANCIAL INSTITUTIONS WAS SHARPLY REDUCED, AND REDISCOUNT LINES WERE CURTAILED. AS A CONSEQUENCE OF THIS TIGHTENING, ONE-MONTH MONEY ON THE INTERBANK MARKET NOW CARRIES AN INTEREST RATE OF 22.5 PERCENT.

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PAGE 02 MADRID 08083 02 OF 04 152213Z

7. WHEN SPEAKING PUBLICLY ON RECENT MONETARY POLICY RENDUELES HAS ALSO CALLED FOR MORE STRUCTURAL REFORMS OF THE FINANCIAL SYSTEM. THE GOVERNMENT'S FINANCING, HE HAS SAID, MUST INCREASINGLY MAKE USE OF TREASURY NOTES AND BILLS, WHICH WOULD PROVIDE THE BANK OF SPAIN WITH BETTER SHORT-TERM CONTROL OVER THE MONEY SUPPLY. RENDUELES HAS ALSO ENDORSED THE JULY 11 OPENING BY THE MADRID EXCHANGE OF A SECONDARY MARKET IN CERTIFICATES OF DEPOSIT.

8. THE FISCAL SITUATION IS ALSO DEVELOPING UNEVENLY, ALTHOUGH SATISFACTORILY. IN THE FIRST QUARTER THE FISCAL DEFICIT WAS MUCH LARGER THAN EXPECTED BECAUSE OF BOTH HIGH EXPENDITURES AND LOW REVENUES. IN THE SECOND QUARTER THIS WAS CORRECTED, SO THAT BOTH EXPENDITURES AND REVENUES IN THE FULL FIRST SEMESTER WERE VERY NEAR BUDGETED LEVELS.

9. THE FISCAL SITUATION IS LESS SATISFYING WHEN EXPENDITURES ARE DISAGGREGATED INTO THOSE FOR CURRENT OPERATIONS AND THOSE FOR INVESTMENT. CURRENT EXPENDITURES ARE UP OVER 46 PERCENT FROM THE SAME PERIOD LAST YEAR, WHILE PUBLIC INVESTMENT IS ACTUALLY DOWN 2 PERCENT. WHEN THE EFFECTS OF INFLATION ARE FACTORED IN, IT BECOMES EVIDENT THAT THE GOVERNMENT IS NOT FULLY IMPLEMENTING ITS PLANNED PUBLIC WORKS PROGRAM. THE MINISTER OF PUBLIC WORKS HAS RECENTLY CONFIRMED THIS AND EXPRESSED THE BELIEF THAT THE GOVERNMENT WAS SIMPLY INCAPABLE OF SHOULDERING A MAJOR EXPANSION OF ITS INVESTMENT ROLE IN THE ECONOMY. THE IMPRESSION GIVEN WAS DISAPPOINTING, AND EVEN A LITTLE UNSETTLING SINCE NEW SCHOOLS ARE THE MAJOR PUBLIC INVESTMENT.

10. THIS FALL THE GOVERNMENT'S PROPOSED BUDGET FOR 1979

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PAGE 03 MADRID 08083 02 OF 04 152213Z

WILL BE PRESENTED. MANY MINISTRIES ARE SEEMINGLY UNAWARE OF THE NEED FOR CONTINUING RESTRAINT AND HAVE BEEN PUSHING FOR INCREASES OF 30 PERCENT OR MORE FOR THE NEXT YEAR. THE MINISTRY OF CULTURE REPORTEDLY ASKED FOR A 200 PERCENT INCREASE IN ITS BUDGET. AS A RESULT THE MINISTRIES OF FINANCE AND ECONOMY ARE RESERVING FOR THEMSELVES MORE OF THE IMPORTANT BUDGET DECISIONS THAN HAS BEEN THE CASE IN THE PAST. THE MINISTRY OF FINANCE WANTS TO HOLD OVERALL EXPENDITURE GROWTH IN 1979 WITHIN THE 16 TO 18 PERCENT RANGE.

11. FOREIGN INVESTMENT IN SPAIN IS PICKING UP THIS YEAR, AS EVIDENCED BY THE STATISTICS ON AUTHORIZED INVESTMENTS. HOWEVER, AS A DISCORDANT NOTE, WEST GERMAN FINANCE MINISTER MATTHOEFER TOLD THE MADRID "EL PAIS" THAT GERMANS NO LONGER FIND SPANISH DIRECT INVESTMENT "ATTRACTIVE" DUE TO MUCH INCREASED LABOR COSTS, THE LOSS OF SOME PREVIOUS SPANISH FISCAL INCENTIVES AND UNSPECIFIED OTHER FACTORS. (IN THE SAME INTERVIEW, MATTHOEFER SAID THAT TO SPEAK OF A POSSIBLE "MARSHALL PLAN" FOR SPAIN AND OTHER COUNTRIES IS AT THE LEAST A MISNOMER SINCE THESE COUNTRIES, UNLIKE GERMANY AFTER WORLD WAR II, DO NOT YET HAVE THE INFRASTRUCTURE TO PROMOTE RAPID INDUSTRIAL GROWTH ON THE BASIS OF MONEY ALONE.)

12. THERE IS NO QUESTION THAT BANKING IN SPAIN IS ATTRACTIVE TO MAJOR FOREIGN BANKS, MOST OF WHICH WELCOMED A JUNE 16 DECREE-LAW WHICH WILL LEAD TO THE OPENING HERE OF NEW BRANCHES (AND PROBABLY SUBSIDIARIES, TOO) OF U.S., EUROPEAN AND JAPANESE BANKS. INTERESTED U.S. BANKS ARE BELIEVED TO INCLUDE CHASE, CITIBANK, MANUFACTURERS HANOVER, MORGAN GUARANTEE, CONTINENTAL BANK AND FIRST NATIONAL OF CHICAGO. BANK OF AMERICA, WHICH ALREADY PARTLY OWNS A SPANISH COMMERCIAL BANK, IS ANOTHER POTENTIAL BENEFACTOR.

13. THE SPANISH EXTERNAL SITUATION IS IMPROVED BUT IS STILL A LONG WAY FROM BEING HEALTHY. FOREIGN EXCHANGE
UNCLASSIFIED

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PAGE 04 MADRID 08083 02 OF 04 152213Z

COFFERS HAVE SWOLLEN BECAUSE TRADE ACCOUNTS HAVE IMPROVED, BECAUSE TOURIST REVENUES ARE UP, AND BECAUSE OF PROCEEDS FROM SIZEABLE, PREVIOUSLY CONTRACTED FOREIGN BORROWING. THE INFLOW OF FOREIGN CURRENCY HAS CERTAINLY BEEN A FACTOR IN THE RECENT APPRECIATION OF THE PESETA AGAINST THE DOLLAR, WHICH HAS REACHED THE POINT THAT MORE

THAN HALF OF LAST SUMMER'S 25 PERCENT DEVALUATION HAS
NOW BEEN WIPE OUT.

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PAGE 01 MADRID 08083 03 OF 04 152211Z
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08
FRB-01 INR-10 NSAE-00 SP-02 STR-07 TRSE-00 LAB-04
SIL-01 OMB-01 EA-12 IO-14 NEA-10 ICA-20 OPIC-06
AGRE-00 SS-15 DOE-15 SOE-02 H-02 HA-05 L-03 PA-02
/159 W

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AMEMBASSY PARIS
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UNCLAS SECTION 03 OF 04 MADRID 08083

USOECD; USEEC

14. A SHORT TERM BENEFIT FROM THE CONTROLLED UPWARD
FLOAT OF THE DOLLAR CAN BE EXPECTED FROM TOURISTS HAVING TO
BRING IN MORE FOREIGN EXCHANGE, BUT THIS FACTOR WILL
BECOME MUCH LESS IMPORTANT AFTER THE JULY-AUGUST TOURIST
SEASON. ON THE NEGATIVE SIDE, SPAIN STILL HAS A LARGE
TRADE DEFICIT AND AN UPWARD MOVING CURRENCY IS LIKE A TAX
ON EXPORTS. ALSO, WHEN DOMESTIC DEMAND RETURNS TO MORE
NORMAL LEVELS, IMPORTS WILL LIKELY SURGE AGAIN, THUS
WIPING OUT AT LEAST PART OF THE PROGRESS MADE OVER THE
PAST YEAR IN NARROWING THE TRADE DEFICIT.

15. MOST EXPERT OBSERVERS BELIEVE THAT THE UNDERLYING
SPANISH TRADE POSITION IS LITTLE IMPROVED OR IS
WEAKENING BECAUSE INFLATION HERE IS STILL ROUGHLY
TWICE AS HIGH AS THE AVERAGE OECD LEVEL. SOME OF THE
MADRID PRINTED MEDIA, HOWEVER, CURRENTLY PREFER THE VIEW
THAT THE PESETA SHOULD BE RVALUED, TO STEM THE RECENT
UNCLASSIFIED

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PAGE 02 MADRID 08083 03 OF 04 152211Z

INFLOW OF FOREIGN CURRENCY. THERE IS NO EVIDENCE THAT THE GOVERNMENT HAS PLANS TO DO ANYTHING EXCEPT PURSUE A MANAGED FLOAT, UPWARD IF NECESSARY, AT LEAST UNTIL THE END OF THIS TOURIST SEASON. IN OUR OWN VIEW THE MOST INTELLIGENT RESPONSE TO THE INFLOW OF FOREIGN CURRENCY IS TO SLOW DOWN FOREIGN BORROWING AS THE GOVERNMENT IS NOW DOING, PARTICULARLY IN THE PUBLIC SECTOR.

16. SPAIN IS CONTINUING ITS NEGOTIATIONS FOR MEMBERSHIP IN EFTA AND IN THE EEC. A SEVENTH ROUND OF THE EFTA NEGOTIATIONS WAS HELD IN LATE JUNE, AND APPARENTLY SOME PROGRESS WAS MADE AS A CONSEQUENCE OF SPAIN DROPPING ITS DEMAND THAT EFTA COUNTRIES AGREE TO MAKE AGRICULTURAL CONCESSIONS. IT NOW APPEARS POSSIBLE THAT SPAIN COULD BE ACCEPTED INTO EFTA BEFORE THE END OF THE YEAR. NOTHING EQUALLY IMPORTANT HAS DEVELOPED IN SPAIN'S NEGOTIATIONS WITH THE EEC WHICH ARE EXPECTED TO BEGIN IN SERIOUS EARLY NEXT YEAR.

17. A. OUTPUT AND DEMAND

- (1) INDUSTRIAL PRODUCTION, TREND INDEX (1962100)
 - 12/76 380.9
 - 12/77 413.4
 - 1/78 416.0
- (2) INDUSTRIAL CAPACITY UTILIZATION (PER CENT)
 - 4TH QTR/76 83
 - 4TH QTR/77 82
 - 1ST QTR/78 79
- (3) INVESTMENT IN PLANT AND EQUIP., TREND INDEX (1962100)
 - 12/76 307.1
 - 12/77 295.1

UNCLASSIFIED

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PAGE 03 MADRID 08083 03 OF 04 152211Z

- 1/78 294.4
- 2/78 293.8
- (4) DEPT. STORE SALES, TREND INDEX (1963100)
 - 12/76 1,420.2
 - 12/77 1,717.4
 - 1/78 1,764.0
 - 2/78 1,807.3
 - 3/78 1,850.5
- (5) STEEL PRODUCTION (1000 METRIC TONS)
 - 1976 10,753.3
 - 1977 10,933.8

- 1/78 890.8
- 2/78 933.9
- (6) DOMESTIC CEMENT CONSUMPTION (1000 METRIC TONS)
- 1976 21,293
- 1977 21,763
- 1/78 1,672
- 2/78 1,671
- (7) DOMESTIC ELECTRICITY DEMAND (MILLION KWH)
- 1976 83,054.2
- 1977 87,031.4
- 3/78 7,722.0
- 4/78 7,463.0
- (8) MADRID STOCK MARKET INDEX (DEC. 31, 1977 100)
- (1977: INDEX DOWN 33 PERCENT)
- JULY 13 102.42
- (9) 1978 NATIONAL INCOME ESTIMATES (GDP):
- (REAL PERCENTAGE INCREASE/DECREASE)

-	LATEST BANK OF SPAIN	OECD
PRIVATE CONSUMPTION	0.8	0.0
PUBLIC CONSUMPTION	3.0	3.5
GROSS CAPITAL FORMATION	-2.0	-4.0

UNCLASSIFIED

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PAGE 04 MADRID 08083 03 OF 04 152211Z

EXPORTS	9.0	8.5
IMPORTS	0.0	1.0
TOTAL GDP	1.7	0.5

- B. PRICE INDEXES
- (1) CPI (JUNE 1976=100)
- 12/76 107.9
- 12/77 136.4

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PAGE 01 MADRID 08083 04 OF 04 171042Z
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UNCLAS SECTION 04 OF 04 MADRID 08083

USOECD; USEEC

- 3/78 141.2
- 4/78 143.6
- 5/78 (PROV) 145.1
- (2) WPI (1955100)
- 12/76 416.3
- 12/77 489.4
- 2/78 501.2
- 3/78 504.7
- 4/78 521.2

- C. MONEY

- (1) MI -- END OF MONTH, NOT SEASONALLY ADJUSTED
- (BILLIONS OF PESETAS)
- 12/76 2,384.7
- 12/77 2,848.0
- 3/78 2,722.8
- 4/78 2,762.3

UNCLASSIFIED

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PAGE 02 MADRID 08083 04 OF 04 171042Z

- (2) M3 -- END OF MONTH, NOT SEASONALLY ADJUSTED
- (BILLIONS OF PESETAS)
- 12/76 6,266.7
- 12/77 7,437.7
- 3/78 7,499.1
- 4/78 7,616.7
- (3) SHORT TERM INTEREST - INTERBANK RATE FOR
- ONE MONTH (PERCENT)
- 12/77 13.1
- 1/78 13.8
- 2/78 8.2
- 3/78 5.3
- 4/78 8.4

- 5/78 12.5
- JULY 13/78 22.5
- (4) LONG TERM INTEREST - AVERAGE INDUSTRIAL
- BANK LOAN
- 15 PERCENT SINCE MID-1977
- D. CENTRAL GOVERNMENT FISCAL RESULTS (NARROWLY
- DEFINED FOR 1-3 BELOW) (BILLIONS OF PESETAS)
- (1) DEFICIT (-) OR SURPLUS
- 1976 13.9
- 1977 88.0
- 3/78 -81.3
- (2) EXPENDITURES
- 1976 910.2
- 1977 1,131.1
- 3/78 177.5
- (3) REVENUES
- 1976 924.1
- 1977 1,163.7
- 3/78 96.2
- (4) NET GOVERNMENT FINANCE

UNCLASSIFIED

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PAGE 03 MADRID 08083 04 OF 04 171042Z

- 1976 96.0
- 1977 297.2
- 3/78 114.0
- E. LABOR
- (1) TOTAL WORKERS (MILLIONS)
- 4TH QTR 1976 13.2
- 4TH QTR 1977 13.3
- 1ST QTR 1978 13.2
- (2) UNEMPLOYMENT PERCENTAGE
- 4TH QTR 1976 5.3
- 4TH QTR 1977 6.3
- 1ST QTR 1978 7.0
- (3) EMIGRATION - NO NEW DATA
- (4) HOURLY WAGE INDEX (TREND) (1976100)
- 12/76 480.6
- 11/77 585.7
- 12/77 608.2
- F. TRADE AND PAYMENTS
- (1) EXPORT VALUE (FOB) (MILLIONS OF DOLLARS)
- 5/78 1,046.6 (\$181.0 PESETAS)
- (2) IMPORT VALUE (CIF) (MILLIONS OF DOLLARS)
- 5/78 1,599.1 (\$181.0 PESETAS)
- (3) BOP CURRENT ACCOUNT BALANCE (BEFORE ADDITION
- OF STANDARD RATIO ADJUSTMENTS) (MILLIONS OF
- DOLLARS)
- 4/77

- TRADE -282.6
- SERVICES 246.1
- TRANSFERS 110.6

- TOTAL 74.0
- (4) FOREIGN EXCHANGE RESERVES (NET OF OBLIGA-
- IONS; EXCLUDING NON-CONVERTIBLE CURRENCY)
- (MILLIONS OF DOLLARS)

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PAGE 04 MADRID 08083 04 OF 04 171042Z

- 5/78 7,293.1
- (5) FOREIGN DEBT - NO NEW DATA
- (6) MADRID DOLLAR EXCHANGE RATE
- (AVERAGE OF OFFICIAL BUYING AND SELLING
- RATES)
- JULY 13 77.492 TODMAN

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